

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE DESIGN AND USE OF SYSTEM DEVELOPMENT CHARGES) ADMINISTRATIVE) CASE NO. 375
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ORDER

System development charges are "one-time charges paid by new development to finance the construction of public facilities needed to serve it."¹ They are also known as "facility expansion charges," "utility expansion charges," "capacity charges," and "impact fees." Water utilities throughout the United States, primarily in areas that are experiencing rapid residential and commercial growth, increasingly have been using such charges as a source of financing for capital improvements.

System development charges are now proposed as the solution to the dilemma of rapid customer growth. One commentator describes the dilemma and its solution as follows:

New capital required for expanding a water and wastewater system to accommodate growth is usually more costly per unit of capacity than historical capital costs for facilities benefiting existing customers. If bonds were issued to finance the full cost of expansion facilities, debt service payments recovered through rates could cause user charges to increase significantly.

System development charges theoretically add equity to the pricing system by requiring the new customer to make up-front contributions so that rates are not increased to

¹ Arthur C. Nelson, System Development Charges for Water, Wastewater and Stormwater Facilities 1 (1995).

finance expansion facilities. In essence, existing customers would not have to subsidize growth.

George A. Raftelis, Comprehensive Guide to Water and Wastewater Finance and Pricing 73 (2d. ed. 1993).

While no public water utility within Kentucky currently assesses a system development charge, some municipal water utilities are assessing such charges to their retail customers. In Case No. 96-616² the Commission considered a municipal utility's application to assess a system development charge upon a public utility. While denying the application on procedural grounds, the Commission found that the concept of system development charges merited further attention and that a formal proceeding should be established to study the issue of system development charges and to solicit the comments of public and municipal water utilities.³

Consistent with those findings, the Commission now initiates this administrative proceeding to examine the following issues: (1) Does the Commission possess the legal authority to establish system development charges? (2) Does a need for such charges exist among Kentucky's public water utilities? (3) Are system development charges fair and reasonable? (4) How should system development charges be designed? (5) How should the Commission, after approving such charges, monitor and review their assessment and administration? (6) How should system development charges that are assessed against public utilities by municipal utilities be administered?

To address these issues, the Commission directs all public and municipal water utilities that are subject to its jurisdiction to respond to the questions appended to this

² Case No. 96-616, The Application of Winchester Municipal Utilities for Approval of the Collection of System Development Charges (Ky. PSC Oct. 3, 1997).

³ Id. at 7.

Order. All water utilities are expected to comply with this directive. After responding to these questions, those utilities that do not wish to participate further in this proceeding may file a notice of withdrawal. Such utilities will be dismissed as parties to this proceeding.

IT IS THEREFORE ORDERED that:

1. An investigation into the design and use of system development charges is opened.

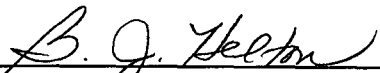
2. All public utilities that supply water service to the public and all municipal utilities that provide wholesale water service to a public utility are made parties to this proceeding.


3. Each party to this proceeding shall file with the Commission, within 45 days of the date of this Order, the original and 8 copies of its response to the questions set forth in Appendix A. Each response should be placed in a bound volume with each item tabbed. When a number of sheets are required for a response, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Careful attention should be given to copied material to ensure its legibility.


4. Any party wishing to withdraw as a party to this proceeding may file a notice of withdrawal with the Commission within 60 days of the date of this Order. Those parties that file a notice of withdrawal shall be dismissed as a party to this proceeding. All utilities, regardless of their filing of a notice of withdrawal, shall comply with Ordering Paragraph 3 of this Order.

Done at Frankfort, Kentucky, this 18th day of December, 1998.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

AN APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN ADMINISTRATIVE CASE NO. 375 DATED DECEMBER 18, 1998

1. What legal authority, if any, does the Public Service Commission presently have to establish or approve a public utility's assessment of a system development charge?

2. Do municipal utilities currently possess the legal authority to assess a system development charge? Explain.

3. a. Does your utility's existing system of rates and charges adequately provide for system development and growth?

b. If no, how is your utility's existing system inadequate?

4. a. Does your utility's existing system of rates and charges provide for a fair and equitable method of ensuring that new development bears its appropriate share of the cost of new facilities to serve such development?

b. If no, how is your utility's existing system inadequate?

5. a. Is your utility presently facing significant growth and development that will require the construction of new facilities?

b. Describe the expected growth and the burdens that it presents.

c. How does your utility expect to finance any new facilities that will be required to meet new growth and development? If rate adjustments are considered, state the expected size of such adjustments.

d. Is your utility interested in establishing a system development charge? Why?

e. What studies, if any, has your utility undertaken regarding the assessment of a system development charge?

f. How does your utility currently deal with new growth and development?

g. Has your utility had any discussion with the public concerning the possible establishment of system development charges? If yes, identify who (e.g., developers, public officials, local businesspersons) has been involved in these discussions and their response to the possible establishment of a system development charge.

6. Is the assessment of a system development charge a fair and reasonable method of allocating the cost of facilities that will serve new customers? Explain.

7. Under what conditions is the use of a system development charge more appropriate than allocating the cost of new development through general rates?

8. If a utility presently has the capacity or ability to serve new customers, should the utility be authorized to assess a system development charge? Explain.

9. What effect, if any, would the assessment of a system development charge have upon economic development within a utility's service area? Explain.

10. What effect, if any, will the assessment of a system development charge have upon low-income and moderate-income housing?

11. What effect, if any, will the assessment of a system development charge have on housing prices in general?

12. What planning studies, if any, should the Commission require of an applicant proposing a system development charge?

13. If the Commission requires planning studies as a prerequisite to the assessment of a system development charge, which of the following should be included in such studies? Explain.

- a. An assessment of existing conditions, including existing facility capacities and weaknesses.
- b. An assessment of the ability of existing facilities to accommodate future development.
- c. A projection of future facility needs.
- d. A determination of the physical and financial dimensions of expanding existing facilities or building new facilities to accommodate new development.
- e. A plan for capital improvements and capital financing to expand or build the facilities to accommodate needs.

14. What factors not listed in Question 13 should be considered in any planning studies? Explain.

15. Under what circumstances, if any, should system development charges be assessed upon certain geographical segments of a utility's service area rather than the utility's entire service area?

16. What factors should be considered in allocating the cost of new facilities to new development?

17. How should system development charges be calculated?

18. System development charges are normally based in part upon the cost of system improvements within a defined planning period. How long should this planning period be?

19. How should grants, developer contributions, and other contributions in aid of construction be considered in developing a system development charge?

20. What measure (meter size, equivalent residential unit, fixture unit, etc.) should be used in assessing the charge? Why?

21. When should a system development charge be assessed: at time of property plotting, development of lot, or customer connection? Explain.

22. When a public utility assesses a system development charge, what special considerations (e.g., a lower charge), if any, should be given to low-income applicants?

23. Under what circumstances, if any, should revenues from a system development charge be used to finance in whole or in part the replacement of existing facilities?

24. What restrictions, if any, should be placed upon the use of revenues from a system development charge?

25. What types of facilities should be financed in whole or in part with revenues from system development charges? Why?

26. Should revenues collected from a system development charge be segregated from other collected revenues and maintained in a separate account?

27. Should a system development charge contain a refund provision that requires refunding unspent system development charges if the facilities covered by the charge are not constructed within a specified time period? Explain.

28. What reporting requirements to the Commission, if any, should be imposed upon a utility authorized to assess a system development charge?

29. a. How frequently should a system development charge be revised to reflect changes in system planning and other considerations?

b. In what form (e.g., rate schedule filing, periodic Commission review proceeding) should these revisions be made?

30. Should the Commission conduct a periodic review of an approved system development charge? If yes, how frequently should such review be conducted? What areas should be covered in such reviews?

31. In what forms (e.g., a flat monthly surcharge), other than a one-time charge, may a system development charge be assessed? What are the advantages of such forms over a one-time charge?

32. If a municipal utility providing wholesale water service to a public utility assesses a system development charge, under what circumstances, if any, should such charge be assessed to the public utility? Explain.

33. If a municipal utility's system development charge is assessed against a public utility, should a different criteria be used to determine the magnitude of the charge than is used for the municipal utility's retail customers?

34. May a municipal utility that assesses a system development charge to a public utility require the public utility to pass that charge directly to its retail customers? Explain.

35. Does your utility currently assess a system development charge?

36. If your utility currently assesses a system development charge,
- a. When was the charge first assessed?
 - b. How much revenue has been collected from the system development charge?
 - c. How is the system development charge calculated?
 - d. For what types of projects/expenditures are revenues from the system development charge used?
 - e. What restrictions, if any, are placed on the use of revenues from the system development charge?
 - f. Provide a copy of the rules, regulation, or ordinance that established and governs the operation of this system development charge.
 - g. What was the local reaction to the establishment of the system development charge?
 - h. To what areas (i.e., system-wide or limited geographical area) is the system development charge applied?